

#MeToo & Tax

Margaret Ryznar*

Abstract

Recently, legislative efforts have taken aim at sexual harassment in the workplace. Among these may be a surprising but effective approach—disallowing tax deductions for sexual harassment settlements subject to non-disclosure agreements. This Essay analyzes such a 2017 tax reform provision.

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I. Introduction

The use of the #MeToo hashtag recently hit the nineteen million mark on Twitter.¹ The movement underlying the hashtag has swept through workplaces from Hollywood² to the federal judiciary, bringing many changes.³

* Professor of Law, Indiana University McKinney School of Law.

1. Dalvin Brown, *19 Million Tweets Later: A Look at #MeToo a Year After the Hashtag Went Viral*, USA TODAY (Oct. 13, 2018, 10:12 PM), <https://www.usatoday.com/story/news/2018/10/13/metoo-impact-hashtag-made-online/1633570002/> (last visited Nov. 2, 2018) (on file with the Washington and Lee Law Review).

2. See Paolo Gaudiano, *From Marilyn Monroe to #MeToo: Sexual Harassment in Hollywood and Beyond*, FORBES (Oct. 29, 2018, 5:00 PM), <https://www.forbes.com/sites/paologaudiano/2018/10/29/from-marilyn-monroe-to-metoo/#6a893973684a> (last visited Nov. 2, 2018) (on file with the Washington and Lee Law Review).

3. See Matt Zapotosky, *Judge Who Quit Over Harassment Allegations*

Additional changes will follow given recent tax reform that prevents the deductibility of sexual harassment settlements subject to a non-disclosure agreement.⁴ To date, such agreements have facilitated sexual harassment in the workplace, particularly among repeat offenders.⁵ The 2017 tax reform aims to curb sexual harassment in the workplace by targeting these non-disclosure agreements.

II. Non-Disclosure Agreements

A common tactic in response to sexual harassment in the workplace is to subject the resulting settlement to a non-disclosure agreement.⁶ Although nondisclosure agreements can protect privacy and facilitate settlement of sexual misconduct claims, there are several concerns arising from the use of such agreements.⁷

A major issue is that non-disclosure agreements help protect repeat sexual harassment offenders.⁸ After they sign a

Reemerges, Dismaying Those Who Accused Him, WASH. POST (July 24, 2018), https://www.washingtonpost.com/world/national-security/judge-who-quit-over-harassment-allegations-reemerges-dismaying-those-who-accused-him/2018/07/23/750a02f2-89db-11e8-a345-a1bf7847b375_story.html?noredirect=on&utm_term=.2c3c3564b356 (last visited Nov. 2, 2018) (on file with the Washington and Lee Law Review); see also Audrey Carlsen et al., *#MeToo Brought down 201 Powerful Men. Nearly Half of Their Replacements Are Women.*, N.Y. TIMES, <https://www.nytimes.com/interactive/2018/10/23/us/metoo-replacements.html> (last updated Oct. 29, 2018) (last visited Nov. 2, 2018) (on file with the Washington and Lee Law Review).

4. See I.R.C. §162(q) (Supp. V 2017); see also Lisa Milam-Perez, *Tax Bill Scraps Employer Deductions for Sexual Harassment Settlements with NDAs Attached*, WOLTERS KLUWER, <http://www.employmentlawdaily.com/index.php/news/tax-bill-scraps-employer-deductions-for-sexual-harassment-settlements-with-ndas-attached/> (last visited Nov. 2, 2018) (describing the history of this provision) (on file with the Washington and Lee Law Review).

5. See *infra* Part II.

6. See Orly Lobel, *NDAs Are Out of Control. Here's What Needs to Change*, HARV. BUS. REV. (Jan. 30, 2018), <https://hbr.org/2018/01/ndas-are-out-of-control-heres-what-needs-to-change> (last visited Nov. 2, 2018) (on file with the Washington and Lee Law Review).

7. See Ian Ayres, *Targeting Repeat Offender NDAs*, 71 STAN. L. REV. ONLINE 76, 77 (2018).

8. *Id.*

non-disclosure agreement, employees often cannot talk to coworkers about the incident. As a result, coworkers experiencing similar harassment cannot use their collective information to identify repeat offenders, who then go undetected for a long period of time. The privacy of settlement agreements also reduces the overall accuracy and availability of the statistics regarding settlement figures and the characteristics of sexual harassment claims.⁹

Non-disclosure agreements not only limit the information available to fellow employees but also to investigators.¹⁰ Specifically, such agreements may cause employees to withhold information from investigators pursuing sexual harassment claims.¹¹ As a result, sexual harassers escape full investigation.¹²

For example, the U.S. Equal Employment Opportunity Commission (EEOC) sought an injunction in the mid-1990s against non-disclosure agreements that were interfering with their investigation of sexual harassment.¹³ In that case, the EEOC struggled to gather necessary information because employees were hindering the discovery process due to their perceived secrecy requirements.¹⁴ Thus, the EEOC sought a preliminary injunction preventing the employer from entering into or enforcing settlement agreements containing provisions that prohibited settling employees from assisting EEOC in its investigation of such

9. See Minna J. Kotkin, *Invisible Settlements, Invisible Discrimination*, 84 N.C. L. REV. 927, 977 (2006); Hope Pordy, *Going Behind the Headlines: Spotlight on Sexual Harassment Law*, 44 VT. B.J., Spring 2018, at 30, 32; Ann Fromholz & Jeanette Laba, *#MeToo Challenges Confidentiality and Nondisclosure Agreements*, L.A. LAW., May 2018 at 12, 14.

10. See Kotkin, *supra* note 9, at 951; Pordy, *supra* note 9, at 32; see *Kalinauskas v. Wong*, 151 F.R.D. 363, 365–66 (D. Nev. 1993) (“[C]ourts must carefully police the circumstances under which litigants seek to protect their interests while concealing legitimate areas of public concern. This concern grows more pressing as additional individuals are harmed by identical or similar action.”).

11. Kotkin, *supra* note 9, at 951.

12. See Frank Fagan, *Systemic Social Media Regulation*, 16 DUKE L. & TECH. REV. 393, 406 (2018); Jessica Post & Dena Sanders, *Fighting Workplace Sexual Harassment State and Federal Approaches*, ARIZ. ATT’Y, Sept. 2018, at 16, 17; Ramit Mizrahi, *Sexual Harassment Law After #MeToo: Looking to California as a Model*, 128 YALE L.J. FORUM 121, 140–41 (2018).

13. *EEOC v. Astra USA, Inc.*, 94 F.3d 738, 740 (1st Cir. 1996).

14. *Id.* at 741–42.

charges.¹⁵ Nonetheless, many people continue to feel restrained from filing charges with the EEOC because of their non-disclosure agreements.¹⁶

Some non-disclosure agreement requirements also have the lopsided effect of only applying to the accuser and not the accused.¹⁷ This puts the accused in a position of power, allowing lopsided bargaining. Secrecy often benefits the more powerful opponent and potentially limits the liability for misconduct.¹⁸

Recently, Congress has started to take aim at sexual harassment. For example, a House Resolution proposed to prohibit the use of public funds to pay awards, settlements, or other compensation in connection with allegations of sexual harassment or sexual misconduct by members or their employees.¹⁹ Meanwhile, a Senate Resolution has proposed to mandate anti-harassment training for all Senators and their employees.²⁰ The initiation, investigation, and resolution of sexual harassment claims within the legislative branch is also the subject of proposed legislation.²¹ Finally, funds over one million dollars can only be granted to contractors who do not condition employment on mandatory arbitration for sexual harassment claims.²²

In the 2017 tax reform, Congress offered an additional tool to curb sexual harassment in the workplace by eliminating the deductibility of sexual harassment settlements subject to a non-

15. *Id.*

16. See Ann Fromholz & Jeanette Laba, *#MeToo Challenges Confidentiality and Nondisclosure Agreements*, L.A. LAW., May 2018 at 12.

17. *Id.*

18. See Judith Resnik, *A2J/A2K: Access to Justice, Access to Knowledge, and Economic Inequalities in Open Courts and Arbitrations*, 96 N.C. L. REV. 605, 613–14 (2018).

19. H.R. Res. 642, 115th Cong. (2017). See also Post & Sanders, *supra* note 12, at 20; Stop Taxpayers Obligations to Perpetrators of Sexual Harassment Act, H.R. 4522, 115th Cong. (2017).

20. Senate Anti-Harassment Training Resolution of 2017, S. Res. 330, 115th Cong. (2017–2018).

21. Congressional Accountability Act of 1995 Reform Act, H.R. 4924, 115th Cong. (2017–2018); S. 2401–Congressional Accountability Act of 1995 Reform Act, 115th Cong. (2017–2018); Congressional Accountability and Harassment Reform Act, S. 2872, 115th Cong. (2017–2018); Congressional Accountability Act of 1995 Reform Act, H.R. 4822, 115th Cong. (2017–2018).

22. Consolidated Appropriations Act of 2017, Pub. L. No. 115-31, § 8096, 131 Stat. 135, 269 (2017).

disclosure agreement. This raises the price of secrecy, lessening the appeal of non-disclosure agreements in sexual harassment settlements.

III. Relevant Tax Reform

Tax drives behavior. There is a strong case that tax laws can incentivize individuals to act in a particular way,²³ but the case is even stronger in the corporate context given the sophistication of corporations, which benefit from extensive legal advice in order to minimize taxes.²⁴ Incentivizing corporate behavior through the taxation system is therefore an area of significant opportunity for legislators.

There are several ways to incentivize behavior through the taxation system, such as by providing 1) a tax deduction that reduces taxable income²⁵ or 2) a tax credit that reduces tax liability

23. For the argument that economic incentives drive women's behavior, see Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 1033, 1040–41 (1993) (arguing that Congress should lower married women's tax rates to encourage both marriage and married women's participation in the labor force). See also Edward J. McCaffery, TAXING WOMEN 19–23 (1997) (noting that because married couples often view the wife's income as supplemental, which is taxed at higher marginal rates, the tax code provides a disincentive for married women to work); Jennifer L. Venghaus, Comment, *Tax Incentives: A Means of Encouraging Research and Development for Homeland Security?*, 37 U. RICH. L. REV. 1213, 1220 (2003) (suggesting that the tax code can change society's behavior). However, other scholars have suggested that the tax code does not influence people's behavior, but that people's behavior influences the tax code. See, e.g., Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1392 (1975) (arguing that the tax code codifies social mores); Erik M. Jensen, Book Review, *Jonathan Barry Forman, Making America Work (The Urban Institute Press, Washington, D.C., 2006)*, 5 PITT. TAX REV. 165, 170 n.16 (2008) (book review) (suggesting that the tax code is indifferent to whether the husband or wife is the primary wage-earner, but that social expectations may be different).

24. See Mark J. Cowan, *A GAAP Critic's Guide to Corporate Income Taxes*, 66 TAX LAW. 209, 232 (2012) ("Policymakers also understand the motivation of corporate managers to minimize taxes and rely on corporate managers to respond to incentives to engage in certain activities—such as investing in new equipment or research and development—put in the tax law.").

25. "An example [on tax deductions] may be helpful here. Assume...A... [has] paid \$1000 under [a] local property tax. Taxpayer A is an itemizer whose income places him in a 15% marginal rate bracket... Because A is able to take the [\$1000] deduction, A will not have to pay \$150 in income tax. A's property tax expense has been subsidized by the federal treasury." Mildred Wigfall Robinson, *It Takes*

dollar for dollar.²⁶ Congress has employed both methods to incentivize certain corporate behavior, in addition to exemptions such as the payroll tax exemption.²⁷

Under the previous tax law, any sexual harassment settlement would be deductible by the employer as an ordinary and necessary business expense.²⁸ The deduction generally included plaintiff's attorney fees and any legal fees the employer incurred for its defense.

The Tax Cuts and Jobs Act of 2017 (TCJA) introduced a new provision in the form of §162(q) to disallow a deduction for sexual harassment settlements subject to nondisclosure agreements.²⁹ This aligns with other tax provisions that prevent deductibility of business expenses on public policy grounds. For example, illegal bribes, kickbacks, and other payments; certain lobbying and political expenditures; and fines and penalties have not been deductible even under the previous tax law.³⁰

Without the deduction, sexual harassment settlements are more expensive for employers who seek to keep these settlements private. The question is whether companies will fight settlement at all, or whether they will just not make it subject to a

A Federalist Village: A Revitalized Property Tax as the Linchpin for Stable, Effective K-12 Public Education Funding, 17 RICH. J.L. & PUB. INT. 549, 583 (2014).

26. See *id.* at 584. ("Unlike an income tax deduction, a credit is taken after tentative federal income tax liability has been determined. It is a dollar-for-dollar reduction of federal tax liability that would otherwise be borne.").

27. For an excellent review of international tax incentives for corporate social responsibility, see Jeyapalan Kasipillai & Shanthi Rachagan, *Tax Incentives and Corporate Social Responsibility*, (presented at the International Congress on Innovation and Regional Economic Development at the University of Science and Technology of China, Dec. 2–4, 2012), <https://perma.cc/3JJR-SQ3U> (reviewing tax incentives for corporate social responsibility in Australia, Canada, China, New Zealand, Singapore, and the United Kingdom).

28. I.R.C. § 162; see also Robert J. Nobile, Sexual Harassment Legal Settlements: What Employers Need to Know about the New Tax Act, Human Resources Guide § 5:57.70 (Oct. 2018).

29. I.R.C. § 162(q). Section 162(q) specifically states: "PAYMENTS RELATED TO SEXUAL HARASSMENT AND SEXUAL ABUSE. – No deduction shall be allowed under this chapter for – (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or (2) attorney's fees related to such a settlement or payment."

30. See I.R.C. § 162(c), (e), (f), and (g).

nondisclosure agreement. Employer response will probably not be uniform—some employers will waive confidentiality to receive a deduction for the settlement. Others, however, may still prefer confidentiality despite its cost.

There is one aspect of this deductibility change that has been clarified in the latter half of 2018—the tax consequences of the settlements received by victims of sexual harassment. Under the previous tax law, they could deduct their attorney’s fees, but it was not clear that the deductibility would survive the tax reform. Recently, all fourteen Republican members of the Senate Finance Committee submitted clarification on this point in a letter to Treasury Secretary Steven Mnuchin dated August 16, 2018.³¹

It will remain to be seen what the results of the nondeductibility provision are for sexual harassment in the workplace. However, it helps make nondisclosure agreements less attractive to companies, and is in line with the nondeductibility of expenses against public policy.

IV. Conclusion

The tax laws have been used for everything from imprisoning Al Capone to reducing smoking.³² Now, they are being used to curb sexual harassment in the workplace by hitting companies where it hurts the most—the wallet.

Among the greatest concerns regarding non-disclosure agreements within the sexual harassment context is repeat offenders continuing to harm employees who feel bound to secrecy and inaction by their non-disclosure agreements. The agreements effect not only communication among co-workers, but also the dissemination of information to investigators and broader public disclosures. Targeting non-disclosure agreements through the tax law aims to make workplaces safer for employees.

31. See, e.g., David Morgan, *Republicans Move to Clarify Tax Provision on Sexual Harassment Claims*, INS. J. (Aug. 21, 2018), <https://www.insurancejournal.com/news/national/2018/08/21/498693.htm> (last visited Nov. 6, 2018) (on file with the Washington and Lee Law Review).

32. See generally *Who Took Down Al Capone? ‘Eliot Ness’ Is the Wrong Guess!*, 108 J. TAX’N 317 (2008); Robert A. Mikos, *State Taxation of Marijuana Distribution and Other Federal Crimes*, 2010 U. CHI. LEGAL F. 223 (2010).

States have also started to consider or enact laws that prohibit or limit confidential settlements.³³ In combination with federal efforts such as the tax change regarding non-disclosure agreements, these laws may help curb sexual harassment in the workplace.

33. See, e.g., Jeff Green & Sahil Kapur, *Tax-Law Typo Risks Bankrupting #MeToo Victims*, L.A. TIMES (June 5, 2018), <http://www.latimes.com/business/la-fi-tax-deduction-metoo-20180605-story.html> (last visited Nov. 6, 2018) (on file with the Washington and Lee Law Review).